

PART I



THE BASICS

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CHAPTER ONE

The Retirement Planning Process

Thomas L. Romens

INTRODUCTION

Retirement! You'll be ready, but will you have the money to do it? Retirement planning is an exploration of alternatives that link present decisions to future implications. The objective of a retirement plan is to identify strategies that you can use to realize your financial goals—goals that will support your plan for living your postretirement years. Failure to link your retirement financing to your life plan in retirement might result in planning for the wrong future or failing to provide financially for the future you planned.

Saving for retirement and planning for it are two different topics. Young people who enter the workforce for the first time are encouraged to save for retirement, but they are not *planning* for retirement—at least not yet. But you are ready to plan. What should you do? How do you start? How much do you need?

The Bogleheads' Guide to Retirement Planning explores the planning process itself, emphasizing the linkage between saving for retirement and actually planning for it. We'll introduce some basic financial planning concepts and provide suggestions regarding how much to save for retirement and how to budget for those savings. Lifestyle choices today directly impact the ability to save for the future. As the poet Robert Burns wrote, "The best laid plans of mice and men often go awry," it is necessary to create a dynamic plan to address the uncertain nature of everyone's health and financial and personal future.

LIFE IN RETIREMENT AND YOUR RETIREMENT WELL-BEING

Retirement as we know it did not exist until the twentieth century. People worked until they could not physically work anymore. There were no pensions, no Social Security, and no Medicare. You were on your own. Most people retired to their children's home or another relative's home, where they lived out the rest of their days.

A new concept of retirement evolved in the 1900s. It focused on a life of rest and leisure paid for by a pension from many years of hard work in an industrial world and modest government subsidies from government-paid Social Security and Medicare. At first, retirement was expected to last only a few years. The retirement age was 65 years when Social Security was created in 1935. That was life expectancy at the time. Accordingly, many people were not expected to live long enough to collect.

Times have changed since the early 1900s; people are living longer, private pensions are diminishing, Social Security benefits are likely to be reduced in the years ahead, and Medicare coverage is becoming very costly. These changes have dramatic implications for future retirees. Baby boomers and beyond must plan retirement differently than their parents or grandparents. Perhaps retirement should be viewed as a third phase in life, potentially equal in duration to the earlier development and full-time work phases of life.

Imagine yourself in retirement for potentially 30-plus years. Where will your income come from? How will you structure this time? Undoubtedly, you will see yourself as a healthy, active person. Following good health practices today, such as watching your weight, cholesterol, and blood pressure and getting regular exercise, can increase your chances of a longer, healthier life span. Unlike earlier phases of your life, you see retirement as unburdened by the pressure to pursue an education and a career. You will want to pursue all the leisure, social, or perhaps political activities that you had no time for while working full-time. A 2004 AARP survey on baby boomers' expectations of life in retirement found that 70 percent

of the baby-boom generation expects to spend more time on a hobby or interest, 68 percent will have more time for recreation, and 51 percent expect to be involved in community service or volunteering.

Those goals are all commendable. But how do you generate the income for your living needs, given diminishing pensions and the cloudy outlook for Social Security? The big change in retirement is that you will probably not be fully retired from gainful employment. Numerous surveys have found that more than 70 percent of retirees expect to work in some capacity, and for some of them, the primary reason will be social fulfillment. Retirement certainly has the potential to be a multifaceted phase of your life.

Money is undoubtedly important, and a steady source of income is critical to a happy retirement. However, money cannot buy happiness. In her book, *You Don't Have to Be Rich: Comfort, Happiness, and Financial Security on Your Own Terms*, Jean Chatzky reports that at the \$50,000 income level, increases in happiness level off. Statistically, people who earn around \$50,000 a year are just as happy as those earning more than \$100,000 per year. Your lifestyle is your choice; simply be aware that studies show that a more expensive lifestyle does not necessarily correlate with additional happiness.

Retirement is about what you are retiring to, not what you are retiring from. In addition to your financial goals, your retirement goals should include the elements of health, social interaction, intellectual stimulation, and happiness. In their book *What Color Is Your Parachute? In Retirement*, Richard N. Bolles and John E. Nelson present some of the findings of Charles Morris, who attempted to define a "good life." His characterization of "ways of life" is a purposeful synopsis of what you might aspire to retire to. Some ways of life described are (a) improvement, working for realistic solutions to specific problems; (b) service, devoting yourself to the greater good and to others; (c) enjoyment, pursuing pleasures and festivities; (d) contemplation, introspection to achieve a more rewarding inner life; and (e) action, using physical energy to accomplish things.

If you are retiring as a couple, it is very important that you agree on a common vision for the future and the strategies that are needed to reach your financial goal. Without consensus, there is the chance that you may be at cross-purposes, a potential recipe for conflict. Planning for the future involves trade-offs; you should agree on what you are willing to give up today in return for your shared vision of life tomorrow.

WHEN TO BEGIN THE RETIREMENT PLANNING PROCESS

Financial planning to support yourself in retirement should begin early in life, although planning *how* you will live your future life in retirement

may not take place until well after you reach your mid-50s. Accumulating assets for retirement can and should begin as soon as you earn steady income, and even before. Parents who have children with earned income can set up a custodial Roth IRA and fund the account up to the extent of the child's earnings, or the maximum allowable by law, whichever is less.

Early retirement planning should begin when you have your first full-time job. Planning at this stage involves having a savings plan so that 40 years later you will have *something* put away for retirement. You may not know how much to save or how long you will need to save, but saving is the beginning.

Many employers have a 401(k), 403(b), or other self-funding defined contribution retirement plan. Study the defined contribution plan options offered by your employer. Choose a broad-based low-expense mutual fund, and contribute at least enough to capture your employer's match. Contribute more if you can—10 to 15 percent of gross income is a good target—but especially take advantage of any raises you earn to increase your contributions. If your employer does not offer a plan, or if the only investment choices are high-expense funds with no employer match, you may be better off establishing a Roth IRA at an investment firm that offers low-cost plans and a low minimum investment amount. All of these concepts are discussed in other chapters throughout this book.

Choosing the right mix of assets at the beginning of your career is not as important as getting started on retirement early and establishing good financial habits. At the beginning, it is the amount that you put into a plan that counts, rather than the return of the investment in the plan.

It is not difficult to budget for retirement savings at an early age because your spending habits have not been developed. One core strategy that works is living below your means; this strategy entails distinguishing between wants and needs and deferring gratification (minimal use of credit and avoiding revolving credit altogether). There are also psychological benefits to getting started early. Money deferred from your paycheck has an out of sight, out of mind quality, and the quarterly statements that report your fund's growth typically offer positive reinforcement for the decisions you have made.

THE TIME VALUE OF MONEY AND OTHER IMPORTANT CONCEPTS

Letting your money work for you is a key component of saving for retirement. Compound interest, dollar cost averaging, tax-deferred savings, and diversification help lower your risk and boost your return on investment over time.

Compound Interest

Compound interest is the interest on your principal plus interest on the interest you earned previously. For example, a single investment of \$10,000 at 5 percent compounded annually earns \$10,789 in interest over 15 years for a net amount of \$20,789. Straight interest would accrue at the rate of \$500 per year, \$7,500 in total interest, for a net amount of \$17,500. When interest is reinvested and compounds at 5 percent, it adds another \$3,298 to the value. That is the magic of compound interest. To calculate compound interest, use one of the many compound interest calculators available on the Internet.

Rule of 72

The rule of 72 offers another interesting perspective on compound interest. Divide the interest rate that an investment is earning into 72, and the quotient is the approximate number of years it will take for that investment to double. For example, an investment with a 7 percent total return will double in about 10 years and a 10 percent return will double in about 7 years.

Starting Early

To illustrate the connection between compound interest and the importance of starting early, here is an example using a scenario from the *Bogleheads' Guide to Investing*. Eric Early starts investing at age 25 and invests \$4,000 each year in a Roth IRA until age 35 and then invests nothing. At 8 percent interest his \$40,000 grows to more than \$629,000 by age 65. Larry Lately begins at age 35 and invests \$4,000 for the next 30 years. Assuming the same 8 percent rate of return on his \$120,000 investment, Larry's Roth account balance at age 65 is \$489,000. It's the power of compound interest over long periods of time that gives Eric the advantage.

Dollar Cost Averaging

Dollar cost averaging is another math-based approach to investing that can boost returns over time. Dollar cost averaging is periodically investing a fixed dollar amount to purchase shares (usually a mutual fund). For example, if you set aside \$100 each month and buy shares in the same mutual fund every month with that contribution, you are dollar cost averaging. It works to your benefit by buying more shares when the

price is down and fewer shares when the price is up. Over a period of time, it lowers the average cost of the shares purchased. If you contribute to a retirement account each year, then by default you are dollar cost averaging.

Tax-Advantaged Savings

Taxes erode retirement savings more than any other expense. You can grow your retirement account faster by using a tax-deferred savings account such as a 401(k), 403(b), 457, SIMPLE or SEP account, traditional IRA, or tax-free Roth IRA. Assume you save \$500 per month for 30 years at 5 percent interest in a tax-deferred or tax-free account. The account grows to a total of \$417,863. If you save the same amount for 30 years in a taxable account, the result is \$364,201 at a 15 percent tax rate or \$324,290 at a 28 percent rate. You will learn more about tax-advantaged strategies in other chapters throughout this book.

Risk Tolerance

All investors should assess their risk tolerance when getting started in investing. Your risk tolerance is an assessment of how you will react psychologically when the stock market and your investments go up and down.

Investors who buy riskier mutual funds could use one or more of the Internet-based risk tolerance assessment tools to help them determine what percentage of their investments they wish to have in stocks and what percentage they wish to have in less volatile investments like bonds and certificates of deposit (CDs). A high risk tolerance indicates an investor who is less likely to sell shares when the market is down, a key attribute needed if you hope to match or beat overall market performance. Do be aware that you probably can't really appreciate your risk tolerance until you pass the sleep test during a major market downturn such as those experienced in the early 1970s, 1987, early 2000s, and in 2008. Down markets of 20 percent or more happen more frequently than people think.

Diversification (Asset Allocation)

Overall portfolio risk is controlled through diversification. In financial planning, diversification of a portfolio is usually referred to as asset allocation. In its simplest form, asset allocation is a recommended percentage of assets that should be in equities (stocks or stock mutual funds) or in fixed income (bonds, money markets, or certificates of deposit).

Rebalancing is the process whereby you periodically adjust the current allocation of your portfolio to stay close to your desired asset allocation, thus controlling your portfolio risk. For example, when the equity percentage is too high because your stocks went up in value, sell some equities and buy more bonds. This sell high and buy low transaction can be an effective strategy to keep you on track to meet your goals. No matter what your risk tolerance is, your asset allocation should become more conservative as you approach retirement age or as you realize your planning goal—regardless of age. Later chapters cover rebalancing in more detail.

CALCULATING YOUR NUMBER

Most couples planning for retirement want a savings number that will tell them when they can retire. In his book *The Number*, Lee Eisenberg refers to it as “how much [you] need to walk away on [your] own terms, never to look back.” Coming up with an accurate savings or net worth number is difficult because you have to weigh numerous factors that affect your decision about when to voluntarily retire: health, age, savings, and lifestyle.

The rule of thumb many financial planners use to determine how much income you will need to maintain your current lifestyle in retirement is 70 to 80 percent of your income while working. Unfortunately, the 70 to 80 percent guide can be an erroneous amount because it is based on earnings, not spending. Many people live on much less than they earn, and others with the same income struggle from paycheck to paycheck. The 70 to 80 percent guide also oversimplifies the issue since it fails to take into account your age at retirement, pension from an employer, eligibility for Social Security benefits and Medicare, postretirement health insurance costs covered by your employer, your health, and even your lifestyle. A better approach is to do a financial plan that includes a detailed retirement budget, as Eisenberg suggests.

LIFESTYLE IMPACT ON SETTING A RETIREMENT DATE

Although many of the elements that comprise our lifestyle do not necessarily bring us more happiness or meaning, we should also consider the trade-offs that lifestyle choices represent. The basic needs of families in the twenty-first century are food, clothing, shelter, and health care. Beyond these needs, most items fall into the wants category, wants being an indicator of your lifestyle and a variable that you can control. A frugal lifestyle would allow you to retire much earlier than a lifestyle designed to keep up with the Joneses. How big a house do you need? How often do

you buy a new car? How important is dining out and entertaining? How important are designer labels and fashion? Think about your value system and what provides meaning and happiness in your life.

Adam Smith, the father of modern economics, made this comment about lifestyles in *The Wealth of Nations* in 1776: “The desire for food is limited in every man by the narrow capacity of the human stomach; but the desire of the conveniences and ornaments of buildings, dress, equipage, and household furniture, seems to have no limit or certain boundary.”

LIFESTYLE CONSIDERATION: THE COST OF TRANSPORTATION

The cost of owning an automobile is a significant expense over a lifetime. When buying an automobile, consider not only the purchase price of the vehicle itself but also the opportunity cost (investment return on money not spent). For example, compare two similar highly rated cars, one with the standard nameplate and the other in the luxury line. Buying the standard version for \$10,000 less every five years results in an out-of-pocket saving of \$80,000 over 40 years. The opportunity rate on those savings in a Roth IRA at 5 percent compound interest for 40 years is \$279,038.

HOW TO CALCULATE YOUR NUMBER

You are now ready to calculate your number, the principal indicator of your ability to support your life plan in retirement. There are many ways to do this calculation; some are simple, and others are very complex. Here is a three-step simple method to *estimate* your number without getting too detailed:

1. Examine your current spending after taxes as a basis for your desired annual income in retirement. Don't include items such as a child's college cost because that will be over by the time you retire.
2. Estimate your future sources of retirement income before investment income. If you are in your mid-50s or older, you can get a fairly accurate picture of your future Social Security benefits from the annual statements provided by the Social Security Administration.
3. Subtract your annual spending before taxes from your future Social Security income and any pension income to find the amount of investment income needed in retirement. The only thing missing is income taxes, which are typically low for a retiree because you are no longer earning high income and you are not paying into Social Security or Medicare. A small adjustment for income taxes may be needed, but don't overestimate that expense.

This calculation may result in a projected annual income shortfall. That difference will have to be made up by taking a distribution from your savings. The question is how to calculate the lump sum you will need based on the annual shortfall.

There are two ways to determine the amount you need at retirement. Financial planners consider a safe withdrawal amount from a retirement portfolio to be about 4 percent of the value per year. That is the industry standard amount that planners believe you can withdraw for the rest of your life and not worry about running out of money. Based on this standard, to find the lump sum amount you need, divide your shortfall by 4 percent (0.04) to calculate your savings goal. For example, if your annual spending, minus projected Social Security and pension benefits, is a \$40,000 shortfall, then you would need investment assets of \$1 million: ($\$40,000/0.04 = \$1,000,000$). Another method to find your lump sum number is to multiply the shortfall by 25 years: ($\$40,000 \times 25 = \$1,000,000$). The 25-year number is derived by dividing 100 percent by 4 percent.

From the \$1 million, subtract your current savings to determine how much you need to accumulate. You can estimate that part of your accumulation will come from growth of your current investments. If you subtract that potential growth, you will arrive at the additional savings you need. For example, if you have already saved \$600,000 and you expect those savings to grow to \$765,000 prior to retirement, the savings target becomes \$235,000: your savings goal during your remaining working years. Note: If you are planning to retire before you receive Social Security or a pension, you will have to plan for additional outlays from savings in your initial retirement years and adjust the numbers accordingly.

A WARNING ABOUT USING SCIENCE IN FINANCIAL PLANNING

Scientific formulas are fine for physics, where there are rigid laws of nature. But they can give you false information in the subjective world of financial planning. The simple method for calculating your number has many assumptions built into the formula, some of which may not be realistic. For example, a 4 percent income level from investments assumes that you desire to have your heirs inherit every dime you ever saved after inflation. If leaving every penny to heirs is not part of your estate plan, or you do not care what anyone gets after you are gone, then you could take out more money without worry. Perhaps you could take out 5 percent per year rather than 4 percent. In that case, you would multiply your income shortfall by 20 rather than 25 to find the number.

Also, the idea that someone is going to spend the same amount of money at age 65 as they do at age 85 is simply not realistic. Department of Labor surveys show that spending goes down with age, particularly when people get into their 80s. At that point, people start to downsize by selling the second car and selling the second home; they do not travel as much or go out to eat as much. Adjustments can and should be made to the number to approximate these decreasing spending habits. Perhaps a realistic number is closer to 17 or 18 times annual income shortfall rather than the rule of thumb of 25 times.

To assure that your retirement assets provide for 30 to 40 years of retirement, you need to do a new calculation each year and adjust for inflation accordingly. These readjustments to your goal account for market fluctuations and other factors that affect your ability to save for retirement. Downsizing and/or relocating to a less costly area are additional means of reducing the difference between total annual income in retirement and the amount indicated as a safe withdrawal from your savings.

Even if you spend considerable time and effort calculating a savings number that will produce a safe, sustainable withdrawal rate in retirement, it is prudent to note an important caveat: Applying rigid scientific formulas to finance are helpful in that they are conceptual, but those formulas cannot account for the unknowns.

Compound interest calculators and savings calculators can project average returns over time, but they cannot project the impact of a major market downturn in the years just before retirement. Nor can they project the loss of a job or a severe decline in real estate values for someone hoping to relocate.

Many financial planners use complex Monte Carlo simulation analysis to predict the probability of successful withdrawal rates, taking into account past inflation and market performance. But those formulas are built around strict scientific laws that do not apply to future economic events. Monte Carlo simulation cannot forecast changes in the tax code, the bankruptcy of a pension plan, or an inheritance.

BUDGETING FOR RETIREMENT

How do you budget for the seemingly staggering amounts needed for retirement? If you are a young investor just starting out, make early, regular contributions to your employer's deferred compensation plan, and establish a savings pattern and lifestyle that never take into account that portion of your income. As an older investor, you have to consider retirement savings a necessary expenditure, not a discretionary one. You will also have the challenge of applying more strategies to meet your goal.

The Young Investor

When starting a new job with an employer who offers a salary deferral or defined contribution plan, how much should you defer? Based on the Social Security tax of 12.4 percent of wages and the fact that Social Security retirement benefits pay out about 40 percent of earnings at age 67, your strategy should ultimately be to save 15 to 20 percent of gross income—more if you plan to retire early. You don't have to start at that level if part of your strategy is to dedicate some or all of your future salary increases to savings until you reach that level. If you are barely making enough to get by, set up a budget and track your spending habits over a few months. Distinguish between wants and needs.

Controlling out-of-pocket expenses can help fund a retirement plan. A partial list of expense items to consider includes credit card debt, clothing purchases, personal care expenses (cosmetics, haircuts, hair dyeing, manicures, pedicures, spa treatments, etc.), cell phone plans, eating out (both lunch and dinner), expensive entertainment, daily lattes and happy hours, lottery tickets, grocery bills (prepared foods and deli items are expensive; many store brands are indistinguishable from national brands), DVDs, iPods, and music downloads.

Also consider some less frequent expenses, such as insurance deductibles and the big hitters—transportation and housing costs. No one expects you to be a hermit, but there are many small purchases made each week that do not significantly impact happiness, social interactivity, or well-being. Jean Chatzky characterizes some of this spending as “unconscious consumption”; if unchecked, such spending undermines your savings goals.

The Older Investor

At this point in your life, your well-established spending habits have provided you with a good idea of how much annual income you will need in retirement. The Social Security and pension income numbers you provided when calculating the savings needed to support your future lifestyle are fairly solid. The gap remaining will need to be filled by future savings and the income from your investments. Returning to the example of a \$1 million goal with \$600,000 saved, if you are 5 years (60 months) from retirement and you expect your investments to return a conservative 5 percent, the calculation is as follows: the \$600,000 current savings earn 5 percent per year over 5 years to grow to about \$765,000, leaving a gap of \$235,000 for which you have to budget. Using a compound interest calculator with length of savings equal to months to retirement, you would have an approximate savings goal of about \$3,500 per month. (This assumes that half of the savings go into tax-deferred accounts.)

If you know how much you can afford to save and how much you need to save, you can also use the same formula to solve for the number of months you must continue to work until you can afford to retire. Choose from a number of online interest calculators at www.analyzenow.com, www.choosetosave.org, www.AARP.org, or www.MSNMoney.com.

If you are approaching retirement, you may need a strategy of savings and cost reductions that go beyond the daily expense controls employed by the younger investor. Think of the process as a lifetime spending plan where you can adjust either your lifestyle today or your time line for tomorrow to achieve your goal. In the example, the \$3,500 per month needed for five years is reduced by \$1,000 per month if you delay retirement by two years.

If you have a hard retirement date, here are some expense reduction and savings strategies: If you have credit card debt, pay it off by using funds you may have in taxable low-yield savings, suspending Roth IRA contributions, taking out a home equity loan if you have a lot of equity (over 50 percent) in your home, or refinancing your mortgage if interest rates are favorable for doing so *and* if refinancing does not greatly extend the length of term of your mortgage. If you own more house than you need, consider downsizing. If you are making car payments or are leasing a car, try to reduce your transportation outlay by selling it and buying a dependable used car for cash. You could also reduce your support of children in college if they are eligible for educational loans since they can borrow for college, particularly if they are old enough to be in a graduate program.

Another cost-saving strategy is adjusting your insurance. Consider raising the insurance deductibles on your home and the collision deductible on your car—or drop the collision deductible altogether if the value of the car is less than \$5,000. If you are paying for a portion of your health care and are in good health, look for a cheaper plan and/or raise your annual deductible. If you are taking prescription medicines, ask for a generic equivalent. Live a healthy lifestyle by not smoking, not drinking in excess, and getting regular exercise. Last, if no one is dependent on your income, drop your life insurance, and if you have a dependent, buy term life insurance.

ADDITIONAL STRATEGIES TO CLOSE AN ANNUAL INCOME GAP

You may be able to reduce some, if not all, of any projected annual income shortfall by selling your home and moving to a less expensive location. If you are a retired couple, ask yourself if you regularly use all the space you have and if you want the furnishings, maintenance, and taxes that go with it. Downsizing from a four-bedroom to a smaller three-bedroom home (net 500 square feet reduction) has the potential of freeing up \$100,000

in cash and reducing ongoing costs for taxes, insurance, and utilities by 5 percent or more per year. Moving to another town may also reduce costs. For example, moving from Chicago to Champaign-Urbana, Illinois, will reduce your living costs by more than 10 percent. Retiring to Mexico or another location south of the border can reduce your living costs by a considerable amount. If you do move out of the country, rent for the first year or so to ensure that the lifestyle suits you.

CHECKING ON YOUR PROGRESS AND MAKING ADJUSTMENTS

A key strategy to keep your plan on track is an annual portfolio checkup as suggested later. Rebalance your asset allocation if the situation warrants. A semiannual review is recommended for individuals in their 50s. The closer you are to your retirement age, the less time you have to recover from adverse events.

ANNUAL AFFORDABLE SPENDING CALCULATIONS

Check your spending and saving habits at least annually, and make adjustments to your retirement savings when necessary. Has the contribution limit for tax-deferred savings increased? Can you save more or redirect savings from a taxable account to a tax-deferred account? Did you get a raise? Did you reduce ongoing expenses, and how did you redirect the money? Have health-care expenses changed? These adjustments do not require a detailed tracking of expenditures, only a big picture approach. Situations change over time, and we all need to be flexible enough to adjust.

CHECKING STRATEGIES AND TRACKING PROGRESS

In the decade before retirement, an annual review should include looking at all the major items that affect your ability to draw down assets at your desired rate in retirement. This includes reviewing your annual Social Security statement and its income projections, employer pensions, employer-sponsored plans (such as 401(k), 403(b), 457, SIMPLE, and SEP), traditional and Roth IRAs, savings in taxable accounts, other sources of income, and any amount that might be freed up from downsizing. On the expense side of the ledger, subtract your savings for the year and your Social Security taxes from your gross income to get a rough estimate of your cost of living. Make adjustments for changes in housing costs, transportation costs, health-insurance premiums, and changes in tax laws that affect both wage earners and retirees. Use an online retirement

savings calculator to see if your current level of savings will allow you to reach your retirement goal.

As you get close to retirement, you can examine the percent withdrawal rate that might be right for you. Based on your current savings and projected postretirement income, how much do you really need to withdraw annually to live comfortably? If you have been a consistent saver and live well below your means, you may find that a 3 percent withdrawal rate allows you ample resources and additional peace of mind.

LIFE'S UNKNOWNNS AND THEIR IMPACT ON RETIREMENT PLANNING

According to a 2008 AARP survey, 51 percent of workers reported retiring earlier than anticipated. Of those who cited one or more negative reasons:

- 54 percent reported leaving due to health or disability
- 33 percent reported leaving due to downsizing or layoffs
- 25 percent left to care for a spouse or other family member

While we can plan for our future and work to create a future of our choosing, we cannot guarantee results. Life happens. We can only anticipate some of the potential threats and prepare contingency plans. The death of a family member, serious illness, and natural disasters are phenomena most dreaded by all of us. Events such as these may alter our lives, our goals, and our futures. Conservative planning, insurance, and emergency savings can cushion some of these blows, but they will still be felt.

Divorce is often a monumental financial setback for both parties. It can be very costly, financially and emotionally, and leave both parties to fend for themselves, rather than pooling their assets and talents. Many divorces result in individuals starting over again with their financial savings. Even living a frugal lifestyle and saving aggressively may not provide enough savings to allow retirement at the desired age.

Loss of employment, family-owned business bankruptcies, and frozen or bankrupt pension plans may also be devastating events. If these setbacks happen to couples as they approach retirement, there is little time to recover, and the only solutions are to continue working past the planned retirement age, or accept a retirement that potentially provides less opportunity to pursue postretirement goals.

The condition of the financial markets has a huge impact on individuals approaching retirement, as well as those who have just entered retirement.

These investors are the most vulnerable to market downswings because they are at a point in their lives when their net worth is at its highest. Higher returns come only with higher risk. If you have reached your financial goal in advance of your desired retirement age, there is good reason to take a more conservative approach to investing.

The effect of a market downturn can be seen in the Employee Benefit Research Institute (EBRI) Survey in Table 1.1. In the 2008 data, note the 15 percent drop in retirees' confidence that they would have enough money to live comfortably in their retirement years. This survey was

TABLE 1.1 RETIREE CONFIDENCE IN HAVING ENOUGH MONEY TO LIVE COMFORTABLY THROUGHOUT THEIR RETIREMENT YEARS

	VERY CONFIDENT	SOMEWHAT CONFIDENT	NOT TOO CONFIDENT	NOT AT ALL CONFIDENT
2008	29	35	17	17
2007	41	38	10	11
2006	40	33	12	13
2005	40	40	12	7
2004	42	27	16	13
2003	39	35	12	11
2002	40	32	16	11
2001	37	37	10	11
2000	34	41	14	11
1999	31	39	20	8
1998	19	28	24	24
1997	33	34	18	11
1996	26	42	20	8

Source: Employee Benefit Research Institute and Mathew Greenwald & Associates, Inc., 1996–2008 Retirement Confidence Surveys®

conducted in January 2008, nine months prior to the financial crisis in October 2008.

Housing downturns also put your plan at risk. As evidenced by the 2008 housing downturn and credit crisis, even the family home can be at risk. Traditional thinking on housing was to buy the biggest house you can afford because it will always go up in value. That may no longer be accurate. The foresight not to put more money into housing than is needed to meet your needs may help you stay on track for retirement.

Changes in the law or the tax code are also unpredictable events that could affect disposable income needed in retirement. Changes that have been proposed in the past, such as increasing income taxes or capital gains taxes or reducing the cost of living adjustment for Social Security benefits would also have an impact on a retiree's standard of living. People approaching retirement and those already retired should be flexible in their planning *and living* to adjust to changes as they occur. Tax law changes may mean a few years of no inflationary increase in annual withdrawals from retirement funds and/or reductions in some discretionary expenses.

Health-care costs in retirement represent both the greatest known additional expense for retirees and the greatest potentially unknown cost. Be mindful that cost of coverage is likely to continue to increase in the years ahead and that the benefits from government programs are apt to decrease. It is prudent for retirees to overestimate health-care costs and underestimate benefits from government health insurance programs.

Although computer models can provide a withdrawal strategy based on inputs, they cannot anticipate scenarios where future investment returns and rates of inflation are vastly different from those of the past or tell you what the cost of health care will be when you really need it. The only way to protect against these unknowns is to rework your plan annually to reflect the new realities.

ADDITIONAL RESOURCES

General Planning for Retirement

- Richard N. Bolles and John E. Nelson, *What Color Is Your Parachute? In Retirement*. Berkeley, CA: Ten Speed Press, 2007. The most introspective book in terms of planning what to do in retirement.
- Jean Chatzky, *You Don't Have to Be Rich: Comfort, Happiness, and Financial Security on Your Own Terms*. New York: Portfolio, Penguin Group USA, 2003. This book is a more balanced mix of the two topics.

- Lee Eisenberg, *The Number: A Completely Different Way to Think about the Rest of Your Life*. New York: Free Press, 2006. An autobiographical style with interesting profiles and case studies.

Financial Planning for Retirement

- Taylor Larimore, Mel Lindauer, and Michael LeBoeuf, *The Bogleheads' Guide to Investing*. Hoboken, NJ: John Wiley & Sons, 2006. A complete guide to investing principles.
- Henry Hebler, *Getting Started in a Financially Secure Retirement*. Hoboken, NJ: John Wiley & Sons, 2007. A well-rounded guide to financial planning and investing for retirement.
- Ed Slott, *Your Complete Retirement Planning Road Map*. New York: Ballantine Books, 2007. More of a reference book than a narrative, with many useful forms and checklists covering a variety of retirement planning situations.

CHAPTER SUMMARY

Saving for retirement should start at an early age, as soon as a person has steady income from employment. Planning for retirement is done later in life, once a person has lived a good many years and is comfortable with present living standards. Everyone over the age of 50 should have a written plan that lays out goals for retirement living and the financing that will support them. Younger planners, too, should have a written plan. Their plan should focus more on examining their personal and financial values, committing to a plan with their partner, establishing some long-range financial goals, and indicating the strategies they will use to achieve them.

If you are within a decade of retirement, your planning should add detail about what you expect to do during your postretirement years. Your annual financial plan adjustments should reflect changes in your life and explore additional strategies for achieving your financial goals if it appears you will fall short. Creating a clear vision of your future life provides the positive affirmation you need to choose the most meaningful course of action today, without a feeling of regret or denial. Above all, stay on track as best you can through good and bad economic times. Focus on what brings happiness to your life, and consider your financial resources as a means to that end.

